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IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

FEDERAL POWER COMMISSION,

v.

MOBIL OIL CORPORATION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF OF RESPONDENT IN OPPOSITION

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BRIEF OF RESPONDENT IN OPPOSITION

The Land and Royalty Owners of Louisiana ("Larola") opposes the petition of the Solicitor General ("Petition"), acting on behalf of the Federal Power Commission, for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case. While other petitions for certiorari have been filed by private parties, and although Larola opposes such petitions and does not waive

its grounds therefor, it has chosen to limit its Brief in Opposition to the Petition in this case.[1]

OPINIONS BELOW

The opinions below are correctly stated by the Petition.

JURISDICTION

The jurisdiction is correctly stated by the Petition.

QUESTION PRESENTED

1. Whether the lessor under an oil and gas lease makes a "sale in interstate commerce of natural gas for resale"[2] and thus becomes a "natural gas company"[3] subject to regulation by the Federal Power Commission as the result of receiving payments for gas royalties provided for in said oil and gas lease when the original lease is not a "sale" of gas, the lessor-royalty owner performs no other act which could evidence a "sale" of gas, and, in law and in fact, owns no gas to sell and has no control over its disposition?

ADDITIONAL QUESTIONS PRESENTED

Although not reached by the court of appeals, which correctly disposed of the case solely on its decision of the first

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1 The other pending petitions for certiorari are: *Mobil Oil Corporation v. Carl F. Matzen, et al.*, No. 71-1169; *Amoco Production Company v. Leland C. Waechter, et al.*, No. 71-1179; *Cities Service Oil Co. v. Carl F. Matzen, et al.*, No. 71-1188; *Shell Oil Company v. Carl F. Matzen, et al.*, No. 71-1191.

2 15 U.S.C. §717(b).

3 15 U.S.C. § 717(a).

question, there are additional questions involved, as follows:

2. Whether the Federal Power Commission may lawfully decide that such a lessor makes a "sale . . . of natural gas for resale" and thus becomes a "natural gas company" subject to regulation without

(a) determining the meaning of the word "sale" as used in the Act,

(b) determining what factual circumstances constitute a "sale" of gas by the lessor-royalty owner,

(c) determining what factual circumstances are present in this record to evidence that a "sale" of gas is made by the lessor-royalty owner,

(d) making a lucid and careful analysis of the facts on which its conclusion is based, and

(e) giving an explicit rationale of the conclusion reached?

3. Whether there is any substantial evidence in this record to support the Federal Power Commission's finding that such a lessor-royalty owner makes a "sale" of natural gas for resale?

STATUTE INVOLVED

The Petition correctly states the statute involved.

STATEMENT

The "Statement" of the Petition seems to be focused upon the history of the private litigation between lessors and lessees which gave rise to the instant proceeding. Larola is *not* interested in the outcome of the private litigation in which the Federal Power Commission became to the producer-lessees a

possible avenue of escape from lease obligations. Larola is profoundly interested in denying the right or necessity of the Commission to exercise jurisdiction over the royalty provisions of private contracts between lessor and lessee affecting private lands.

The record herein is uncontradicted that in the normal lease situation a landowner, prior to the time when natural gas is or is not known to exist under his premises, grants to a lessee a mineral lease which gives the lessee the exclusive right to go upon the leased premises, explore and develop the property, and, if gas is discovered, take into the lessee's exclusive possession 100% of such gas, sell it as the lessee chooses, for what price the lessee chooses, and for what terms the lessee chooses. The mineral lessor has no legal, factual or economic control or right of control over any of the actions of the lessee in producing and marketing the gas.

The mineral lease is usually granted in consideration of the payment of a cash bonus, of payments of delay rentals for the privilege of deferring drilling, and of payments by the lessee to the lessor of royalties on all gas produced. Gas royalties are calculatted on a fraction (usually 1/8th) of either the amounts received by the lessee or of the market value of such fraction. Traditionally sales of gas to pipelines by lessees have been based on a stated price per Mcf. This means that the lessor's royalty payments are usually also calculated on volumes produced and are paid either on the basis of the amounts received by the lessee or on the market value in the field.

Royalty costs are only a fraction of a producer's total costs. The Federal Power Commission has not undertaken to regulate any of the producer's other costs. There is no substantial evidence in the record of this proceeding to establish that the failure to regulate royalty payments will materially

adversely affect either the consumer, the pipeline purchaser or the producing industry generally. There is not even any substantial evidence that the giant oil companies here involved would be materially adversely affected in their nationwide operations. There is no substantial evidence in this record that the current or future area rates for producers will require upward adjustment as the result of the unregulated royalty payments.

These are the facts upon which the jurisdictional question turns.

REASONS FOR DENYING THE WRIT OF CERTIORARI

The decision below is clearly correct in holding that, in the ordinary lease situation, the recipient of royalty payments makes no sale of natural gas for resale in interstate commerce. He owns no gas, has neither legal, factual nor economic control over its production, use or disposition and does nothing which could possibly be construed as a "sale". The decision below does not conflict in principle with prior decisions of this Court. There is, in fact, no "regulatory gap". The interest of the consumer is already protected; the only interests that would be protected here are those of private litigants who have made bargains which they do not wish to fulfill.

1. The court of appeals quite properly found[4] that, for jurisdiction to attach under the Natural Gas Act, a royalty owner must be held to be engaged in a sale in interstate commerce of natural gas for resale. Whether landowners or other royalty owners are engaged in the sale of natural gas in

4 Mobil App. 22-25. "Mobil App." references are to the Appendices to Mobil Oil Corporation's petition for certiorari in No. 71-1169.

interstate commerce within the meaning of Section 1(b) of the Act must be determined by reference to the intention of Congress. The court, following the *Rayne Field* case *(United States Improvement Co. v. Continental Oil Co.*, 381 U. S. 392) stated that Congress' intention cannot be conclusively determined by reference to classifications under state law. But it found that, as a point of departure, it is necessary to begin with the presumption that Congress had in mind the ordinary, usual and natural sense of the word "sale". The court found that generally the recipient of royalties is not considered, either in common parlance or in state law decisions, to be engaged in a "sale". This was the same concept that was expressed in the opinion of this Court in *Burnett v. Harmel*, 287 U. S. 103. Relying upon the normal and usual meaning of the word "sale" as it existed when the Natural Gas Act was passed, the court found that the factual incidents to the receipt of royalties by a landowner did not involve a "sale" in its usual and normal sense and that, therefore, Congress did not intend to include within the Commission's jurisdiction the regulation of royalty payments.

This was as far as the court below needed to go, and it was completely correct under the prior decisions of this Court which the court of appeal cited.

2. The Petition (p. 9) concludes that the principles announced in the *Rayne Field* case, *supra*, and in the case of *California v. Lo-Vaca Gathering Company*, 379 U. S. 366, require that the "economic realities and physical facts" determine the extent of jurisdiction under the Natural Gas Act – presumably in disregard of the words of the Act. We think it too clear for extended discussion that, if royalty payments were not included within the word "sale" under the Act and jurisdiction to regulate them not conferred, it makes no difference what the so-called "economic realities and physical

facts" are. The opinion of the court of appeals quite clearly demonstrates this.[5]

The Petition seems to infer that the court of appeals departed from the decisions of this Court and governed its decision on technical concepts of local law. Nothing could be further from the fact. The court of appeals considered these same contentions most carefully and disposed of them. It would be a work of supererogation here to attempt to embroider upon the concise and perceptive exposition of the different principles involved given by the court below. We commend this exposition[6] to this Court's attention.

Be all that as it may, however, the "economic realities and physical facts" here do not support the existence of a sale. The royalty recipient has no legal or factual right to take the gas, to use the gas, to dispose of the gas, to control its disposition, to determine to whom the gas is to be sold by the lessee, nor to determine the price per Mcf the lessee is to receive for the gas. The royalty recipient thus has none of the aspects of economic control. If the royalty recipient's lease contract (as did some old leases) provided that the lessor was to be paid $100.00 per well per year for all gas produced from the leased premises, no one could contend that a "sale" existed. The thrust of the Petition's argument appears to be that because the lease provisions require that the royalty payments be calculated on a fraction of the volumes produced and disposed of *by the lessee*, this *ipso facto* results in a sale of *gas by the royalty* recipient. In other words, the distinction to be drawn from the Petition seems to be that calculation on fractions and volumes is the sole necessary ingredient to a "sale". This flies in the face of all law and of the economic facts here.

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5 Mobil App. 25-31.

6 Mobil App. 25-29.

3. The Petition (p. 9) contends that the lessor, by entering into a mineral lease, "in effect" appoints the lessee as its agent to market any gas produced from the lease. It is difficult to comprehend how the lessor could appoint the lessee as the lessor's agent to sell the *lessee's own gas.* Beyond that, the leases on their face do not purport to create any such agency. In order for the relationship to exist in derogation of the private contract there must be some exercise of actual control by the principal over the actions of the agent – so-called "economic control" does not suffice.[7] Here, the facts in the record clearly show, as has been above demonstrated, that there exists neither actual nor economic control by the lessor over the lessee's marketing of 100% of the gas produced. There is no need to decide a question of law; under any tenable theory of law the facts show that no such "agency" exists.

4. The Petition argues (pp. 11-12) that a regulatory gap exists if royalty recipients are not regulated; that Congress intended no regulatory gap to exist; and that effective regulation requires that royalty payments be regulated. The short answer to this argument is that if Congress did not in the Natural Gas Act include royalty recipients within the definition of "natural gas companies", it makes no difference whether a regulatory gap exists or not. As the court below explained,[8] the existence of a need for regulation cannot excuse an agency's exercise of a power which was not granted to it. None of the decisions of this Court had held to the contrary.

Moreover, the Solicitor General is misinformed as to the existence of a regulatory gap. This Court has held that the

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7 *Cf. National Labor Relations Board v. Steinberg,* 182 F. (2d) 850 (C.A. 5th, 1950).

8 Mobil App. 30. *Cf. Civil Aeronautics Board v. Delta Airlines,* 367 U.S. 316.

principal purpose of the Natural Gas Act was the protection of the consumers. *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U. S. 378. The consumers are now being protected by the Commission's area price regulation of producers. The Commission's jurisdiction of the producer's price, as Commissioner O'Connor pointed out,[9] is sufficient to protect the consumer against royalty payments at any level. Under the present method of area rate regulation[10] an independent producer is not entitled to any increase in area rates for past payments of "excessive" royalties (which have already been taken into account in producer costs). Nor would the independent producer be entitled to increases in rates for future production because of the method of calculating royalty costs for new gas well gas. As expressed in Opinion No. 598 of the Federal Power Commission, issued July 16, 1971 (46 F.P.C.), at pages 53 through 56, a nationwide royalty cost in cents per Mcf is determined, which figure is derivative in the sense that the ultimate rate must first be determined and then a percentage applied. This percentage relates to the royalty fraction and not to the amount per Mcf paid as royalty by the individual producer to those entitled to royalties under the lease which he holds. Thus, when the Petition states (p. 12) "that the owners would in many instances receive compensation in excess of the royalty component allowed in the area rates determined by the Commission", the Petition is wholly in error for there is no "compensation" established by the royalty component of the area rate costing concept.

The consumers are being protected. There is no more need to regulate royalty payments than there is to regulate geophysical costs, drilling rig costs, drill pipe and casing costs,

9 Mobil App. 79 (dissent).

10 This Court has approved this method in the *Permian Basin Area Rate Case*, 390 U.S. 747.

well equipment costs, drilling crews' wages, executive salaries and overhead, or any of the other costs that a producer must incur in prospecting for and producing the gas that flows into commerce. Nor is there any need to protect the producers from the consequences of contracts voluntarily entered into, even if the Federal Power Commission enjoyed such power. The producers are well able to protect themselves in the lease contracts. In short, there is no public interest requiring the exercise of this Court's certiorari jurisdiction.

5. Because the lower court did not reach the questions raised below by Larola as to items 2 and 3 listed under "Additional Questions Presented", *supra*, pp. 2-3, and in the interest of brevity, no argument as to these questions will be made in this brief. However, the Court's attention is respectfully directed to Larola's claim that, even had jurisdiction existed, the Commission's errors would have required reversal.

CONCLUSION

It is respectfully submitted that the petition for a writ of certiorari should be denied.

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Respectfully submitted,

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